

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 MADRID 4214

E.O. 11652 GDS

TAGS: PFOR, PINT, EGEN, SP, PO

SUBJECT: SPAIN: QUARTERLY TRENDS REPORT

1. SUMMARY. POLITICAL DEVELOPMENTS ELSEWHERE IN EUROPE, PARTICULARLY IN PORTUGAL HAVE HAD PROVOCATIVE AND UNSETTLING AFFECTS ON POLITICAL LIFE, AGGRAVATING LATENT POLARIZATION, INDUCING GREATER GOVT CAUTION ON RAPID LIBERALIZATION, AND CONTRIBUTING TO SENSE OF POLITICAL UNEASE. DEBATE OVER MEANING OF PORTUGUESE EVENTS FOR SPAIN, AND OVER SPAIN'S OWN POLITICAL FUTURE, HAS TAKEN ON UNUSUAL STRIDENCE, IN PART BECAUSE OF INCREASED MEDIA FREEDOM. RIGHT-WING HAS SHOWN RENEWED VIGOR AND AGGRESSIVENESS IN RESPONDING TO WHAT THEY SEE AS THREAT OF RAPID LIBERALIZATION. RECENT GOVT STATEMENTS CONFIRM THAT PROPOSALS FOR LIBERALIZATION WILL BE IMPLEMENTED UNHASTILY AND FIRMLY WITHIN FRAMEWORK EXISTING INSTITUTIONS. GOVT'S OVERRIDING ECONOMIC POLICY DILEMMA CONTINUES TO BE CONFIDENTIAL

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THAT OF CURBING INFLATION WHILE MAINTAINING GROWTH. EXPANSIONIST

POLICY FOLLOWED SO

FAR HAS BEEN RELATIVELY SUCCESSFUL IN MAINTAINING GROWTH RATE AND REAL

WAGE INCREASES BUT HAS BEEN ACCOMPANIED BY INFLATION RATE ABOVE OECD AVERAGE. GOVT'S "BELT-TIGHTENING" PLANS TO FURTHER RESTRICT CREDIT AND REIN IN WAGES COULD YIELD SOCIAL AND POLITICAL STRESSES. BALANCE OF PAYMENTS DEFICIT, NOW APPROACHING TWO BILLION FOR YEAR, IS RESULT OF PETROLEUM PRICE INCREASES AND ACCOMPANYING DECLINE OF TOURISM. SPAIN'S TRADE DEFICIT WITH US COULD IN 1974 REACH 1.6BILLION DOLLARS, TWICE LEVEL OF 1973. GOS SPOKESMAN SO FAR PROFESS INTENTION TO AVOID SUCH TACTICS AS IMPORT RESTRICTIONS OR COMPETITIVE DEVALUATION IN REMEDYING BALANCE OF PAYMENTS DIFFICULTIES. END SUMMARY.

2. EXTERNAL DEVELOPMENTS AS MUCH AS INTERNAL FORCES HAVE SHAPED SPAIN'S POLITICAL TRENDS DURING PAST THREE MONTHS. WHILE COLLAPSE IN PORTUGAL OF SALAZARIST INSTITUTIONS HAD MOST TELLING IMPACT ON POLITICAL ATTITUDES, ENDORSEMENT OF DIVORCE IN ITALY, DEFEAT OF GAULISM IN NEIGHBORING FRANCE, AND UNEXPECTED GOVT TURNOVERS IN UK AND FRG ALSO HAD PROVOCATIVE AND UNSETTLING EFFECTS. SPECIFICALLY, EVENTS IN PORTUGAL AND ELSEWHERE IN EUROPE HAVE:

- MADE SPANIARDS MORE AWARE OF INEVITABILITY OF CHANGE AND CREATED VAGUE SENSE OF EXPECTANCY AND CONCERN WHICH, TOGETHER WITH INCREASINGLY APPARENT DECELERATION OF THE ECONOMY HAVE CONTRIBUTED TO POLITICAL UNEASE.
- LENT NEW URGENCY TO CONTINUING DEBATE OVER PACE AND OBJECTIVES OF POLITICAL CHANGE, WHICH HAS IN TURN EXPOSED AND FURTHER STIMULATED LATENT POLARIZATION IN SPANISH POLITICS.
- STIMULATED FURTHER MOBILIZATION AND COALESCENCE OF THE FRAGMENTED RIGHT-WING, WHICH ALREADY CONCERNED OVER IMPLICATIONS OF POLITICAL LIBERALIZATION PROGRAM.
- ANIMATED OPPOSITION, PARTICULARLY OUTSIDE SPAIN, AND ENCOURAGED THEM TO STEP UP EFFORTS TO SUBVERT FRANCO REGIME.
- HEIGHTENED GOVT'S CAUTION TOWARD FURTHER LIBERALIZATION EXPERIMENTS.
- BECAUSE OF DISAPPEARANCE OF PORTUGUESE REGIME, SPAIN'S LAST POLITICAL ANALOGUE IN EUROPE, EVENTS HAVE REINFORCED SPAIN'S CONFIDENTIAL

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SENSE OF ISOLATION WITHIN EUROPE AND LED TO FURTHER REVALUATION OF SPAIN'S EXTRA-EUROPEAN TIES, PARTICULARLY TO US, VATICAN AND ARAB WORLD.

3. THERE HAS BEEN WIDE AGREEMENT IN POLITICAL CIRCLES THAT THERE IS RELEVANCE FOR SPAIN IN PORTUGUESE EVENTS, BUT THERE ARE CRITICAL DIFFERENCES OVER WHAT PRECISELY THAT RELEVANCE IS. PROPONENTS OF LIBERALIZATION IMMEDIATELY SAW COUP AS ADDED EVIDENCE THAT CONTINUED IMMOBILISM IN SPAIN WILL LEAD ULTIMATELY TO UPHEAVAL--OUTCOME WHICH CAN BE AVOIDED ONLY BY FAR-REACHING AND RAPID LIBERALIZATION BEFORE DEPARTURE OF FRANCO. FOR RIGHTISTS, WHO OF COURSE FEEL PORTUGUESE EXPERIENCE IS TO BE AVOIDED RATHER THAN EMULATED, LESSON FOR SPAIN IS THAT EXISTING SYSTEM

MUST BE STRENGTHENED AND THAT LIBERALIZING STEPS OF RECENT YEARS WHICH HAVE ERODED IT MUST BE HALTED AND IF POSSIBLE REVERSED. MANY IF NOT MOST APOLITICAL SPANIARDS, HOWEVER, STILL DEFERRING ANY FINAL CONCLUSIONS ABOUT LESSON OF PORTUGUESE EVENTS. GROWTH OF SERIOUS DISORDER IN PORTUGAL OR EMERGENCE OF HARSH AUTHORITARIAN REGIME THERE WOULD PROBABLY BE ADDED INDUCEMENT FOR MANY IN THIS FLOATING GROUP TO CONTINUE THEIR PASSIVE ACCEPTANCE OF PRESENT SYSTEM WHICH HAS AT LEAST OFFERED PEACE AND STABILITY.

4. MOUNTING PUBLIC DEBATE OVER SPAIN'S POLITICAL FUTURE AND SIGNIFICANCE OF PORTUGAL FOR IT HAS TAKEN ON UNACCUSTOMED BITTERNESS AND STRIDENCE. WHILE THIS TO SOME EXTENT REFLECTS UNDERLYING POLARIZATION OF SPANISH POLITICAL LIFE, MUCH OF IT DUE TO UNUSUAL PRESS FREEDOM ARIAS GOVT HAS TOLERATED. OVERALL GOVT ATTITUDE TOWARD FREEDOM OF EXPRESSION, HOWEVER, REMAINS INCONSISTENT, INDICATING SOME DISSENSION WITHIN GOVT ON MEDIA POLICY. OCCASIONAL RECENT SEIZURES OF PERIODICALS HAVE BEEN DIRECTED BY PUBLIC ORDER COURT OR LAW ENFORCEMENT AGENCIES, IN ABSENCE OF ACTION BY MORE LIBERAL MINISTRY OF INFORMATION. RELATIVE PRESS FREEDOM HAS ALSO CONTRASTED NOTICEABLY WITH FREQUENT GOVERNMENT SUPPRESSION OF LECTURES, CULTURAL ACTS AND OTHER GATHERINGS WITH POTENTIAL POLITICAL FLAVOR. PRESS IN GENERAL AND INFORMATION MINISTER HAVE STUCK TO LIBERAL POLICY DESPITE HEAVY FIRE BY CONSERVATIVE SECTORS FOR ALLEGED PERMISSIVENESS AND DISRESPECT FOR INSTITUTIONS.

5. RIGHT-WING GROUPS HAVE AT SAME TIME BEEN INCREASINGLY VOCIFEROUS IN WARNINGS ABOUT POLITICAL ADVENTURES WHICH WOULD
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NOT BE CONSISTENT WITH REGIME TENETS. FORMER FALANGE LEADERS SUCH AS JOSE ANTONIO GIRON, ULTRA-CONSERVATIVES SUCH AS GEN GARCIA REBULL AND NATIONAL COUNCILMAN BLAS PINAR, AND LEADERS OF VETERAN'S ORGANIZATIONS HAVE ALL PLEDGED THEMSELVES TO DEFEND LEGITIMACY AND INTEGRITY OF FRANCOIST INSTITUTIONS. POWERFUL RIGHT-WING GROUPS OPPOSED TO CHANGE APPEAR TO HAVE SOME ENCOURAGEMENT FROM FRANCO AND SOME OF HIS PERSONAL ADVISORS.

6. GOVT'S PROGRAM OF LIBERALIZATION ANNOUNCED FEB 12 HAS LED TO SUBMISSION OF DRAFT LAWS ON LOCAL GOVT AND PARLIAMENTARY INCOMPATIBILITIES. ALTHOUGH ARIAS HAS MET PROMISED DEADLINES, SUBSTANCE OF LAWS FALLS SHORT OF EXPECTATIONS OF EVEN MANY MODERATE LIBERALS SINCE MAYORS WILL NOT BE DIRECTLY ELECTED AND GOVT'S APPROVAL OF POLITICAL ASSOCIATIONS, CONSIDERED SINE QUO NON FOR EFFECTIVE PARTICIPATION, WILL APPARENTLY BE LIMITED TO GROUPS WITHIN GOVT-CONTROLLED NATIONAL MOVEMENT. ABRUPT REMOVAL OF RELATIVELY LIBERAL GENERAL DIEZ-ALEGRIA, AS CHIEF OF HIGH GENERAL STAFF, WHILE NOT DIRECTLY LINKED TO DOMESTIC POLITICS, PERCEIVED BY MANY MODERATES AND LIBERALS AS ADDED BLOW TO LIBERALIZATION. MEANWHILE, GOVT ITSELF BY WORD AND DEED CONTINUES MAKE CLEAR THAT PUBLIC ORDER AND

INTERNAL SECURITY REMAIN HIGHEST PRIORITY GOALS. IN ANY CASE,
ARIAS' JUNE 15 ADDRESS FOR MANY WAS CONFIRMATION THAT GOVT HAS
STEPPED BACK FROM ORIGINAL PROMISES IMPLICIT IN FEB 12 SPEECH.

7. GOVT HAS CONTINUED TO INCREASE POLITICAL EXPOSURE OF MONARCHY,
CULMINATING IN FULL CABINET VISIT TO PRINCE JUAN CARLOS JUNE
24 IN CALCULATED GESTURE OF ALLEGIANCE TO PRINCE'S FUTURE ROLE.
PRINCE'S FATHER, DON JUAN, HAS ADOPTED NON-INTERFERENCE POSTURE,
PRESUMABLY TO AVOID
COMPROMISING SON'S FUTURE AS KING.

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8. GOVT HAS COME UNDER SOME CRITICISM FOR ITS SEEMING LACK OF
INITIATIVE IN FOREIGN AFFAIRS AND ITS INDIFFERENCE TO EUROPEAN
OPTION. VISIT OF FOREIGN MINISTER TO US AND PROSPECT OF SPANISH
-US JOINT DECLARATION HAS LED SOME TO VOICE FEARS THAT GOS GOING
INTO BASE NEGOTIATIONS WITH US WITHOUT CLEAR DEADLINE TO OBTAIN
MORE THAN PREVIOUSLY AND IS RESIGNED TO CONTINUING CURRENT
ARRANGEMENT, THUS, ACCORDING TO SOME, CLOSING DOORS TO FUTURE
RAPPROCHEMENT WITH EUROPE.

9. PARAMOUNT POLICY CONCERN IN THE SPANISH ECONOMIC SITUATION
REMAINS HOW TO CONTROL INFLATION WHILE MAINTAINING GROWTH AND
EMPLOYMENT AT HIGH LEVELS. THE DEBATE OF WHETHER TO ADOPT
CONTRACTIONARY MEASURES OR TO ANTICIPATE A DROP IN DEMAND BY

RESORTING TO STIMULATIVE DEVICES WAS LARGELY RESOLVED IN FAVOR OF THE LATTER-AT LEAST THROUGH THE FIRST FOUR OR FIVE MONTHS OF 1974. RELATIVELY EXPANSIONIST POLICY APPROACH RESULTED
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IN INDUSTRIALTSBODUCTION GROWTH OF 5.8 PERCENT COMPARING THE FIRST QUARTER 1974 WITH THE LAST QUARTER 1973. THIS GROWTH HAS BEEN ACCOMPANIED BY ONLY SLIGHT INCREASE IN UNEMPLOYMENT SINCE YEAR'S END AND BY HIGH RATE OF INCRDEXE IN INVESTMENT.

10. INFLATIONARY RATE HAS RISEN FROM LAST YEAR'S 14 PERCENT TO CURRENT 16 PERCENT ANNUAL RATE. THIS IS 4 PERCENT ABOVE THE OECD AVERAGE, ABOUT SAME AS ITALY, AND OF ALL THE MAJOR COUNTRIES, ONLY BETTER THAN JAPAN. WAGE CONTRACT SETTLEMENTS ARE PRIVIDING AVERAGE ANNUAL INCREASES IN THE RANGE OF 20-25 PERCENT, SO THAT REAL WAGE GAINS ARE STILL BEING REGISTERED. GOS, HOWEVER, EXPECTS THIS WILL MODERATE AS THE YEAR EVOLVES. THIS BELT-TIGHTENING "MODERATION" COULD GENERATE DIFFICULT-TO-HANDLE SOCIAL-POLITICAL STRESSES, IF IN FACT THE GOVT CARRIES THROUGH ON ITS PLAN TO HOLD A TIGHTER REIN ON WAGES. LABOR SCENE HAS BEEN RELATIVELY QUIET, WITH MANY SMALL STRIKES OVER LABOR ISSUES IN CERTAIN AREAS (E.G. THE BASQUE COUNTRY), BUT WITH ONLY ONE MAJOR STIKE AT THE LEYLAND MOTORS AUTOMOBILE PLANT IN PAMPLONA. MOST OBSERVERS BELIEVE THAT LABOR UNREST AND AGITATION WILL PICK UP CONSIDERABLY IN THE FALL WHEN FUEL, ECONOMIC IMPACT OF INFLATION, ENERGY CRISIS, AND DECREASED TOURISM, WILL REALLY BEGIN TO BE FELT BY THE WORKERS.

11. SPECTER OF INFLATION HANGS HEAVY, AND THE INCREASING SWITCH TO MORE ORTHODOX THINKING ON THIS ISSUE IN OTHER COUNTRIES HAS LED TO SECOND THOUGHTS IN SPAIN. ONE MEASURABLE RESPONSE TO INFLATION (AND FRANTIC FIRST QUARTER ACTIVITY) HAS BEEN A DRYING UP OF CREDIT, WHICH REFLECTS A VIRTUAL ZERO-LEVEL BANK LIQUIDITY IN APRIL. FINANCE MINISTER HAS INDICATED THE SQUEEZE WILL LAST UNTIL SEPTEMBER, WHICH COULD CAUSE CRISIS SITUATIONS IN MANY ENTERPRISES. PRIVATE SECTOR CREDIT, WHICH WAS GROWING AT AN UNPRECEDENTED ANNUAL RATE OF 37.6 PERCENT IN APRIL, WILL BE REDUCED TO A 24 PERCENT ANNUAL RATE BY YEAR'S END, ACCORDING TO THE GOVT'S PLAN.

12. OFFICIAL GOS NEGATIVE PREDICTIONS OF LAGGING DEMAND AND GENERAL DECELERATION IN THE ECONOMY FROM NOW ON BEAR OUT FORECASTS EARLIER THIS YEAR THAT SECOND HALF OF 1974 WOULD BE SLOWER THAN THE FIRST. FOR TIME BEING, THE EMBASSY STICKS WITH ITS PREDICTION OF 4 PERCENT REAL GNP GROWTH AND 17 PERCENT INFLATIONARY RATE FOR THE WHOLE YEAR 1974.

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13. FOURFOLD PETROLEUM PRICE INCREASE HAS HAD ITS MOST TELLING EFFECT IN EXTERNAL SECTOR. ADDITIONAL COST IN 1974 FOR PETROLEUM

IMPORTS IS NOW ESTIMATED AT \$2.2 BILLION, EXACERBATING SPAIN'S CHRONIC BALANCE OF TRADE DEFICIT. FOR THE FIRST FOUR MONTHS OF 1974 ACCUMULATED TRADE DEFICIT WAS \$2.4 BILLION, TWICE WHAT IT WAS FOR THE SAME PERIOD LAST YEAR. ORDINARILY THIS TRADE DEFICIT HAS BEEN IN LARGE PART COMPENSATED FOR BY TOURISM, WHICH UNFORTUNATELY IS ALSO PRONE TO EFFECTS OF PETROLEUM PRICE DEVELOPMENTS. THERE HAS BEEN A NOTICEABLE, THOUGH SLIGHT, DOWNTURN IN THE NUMBER OF TOURISTS ENTERING SPAIN; RATHER THAN THE ACCUSTOMED 5-10 PERCENT GROWTH RATE, THERE HAS BEEN A 1 PERCENT DECLINE OVER THE FIRST FOUR MONTHS OF THE YEAR. FOREIGN EXCHANGE EARNINGS FROM TOURISM FOR THE SAME PERIOD ARE UP 9.5 PERCENT, BUT THIS DOES NOT MATCH THE INFLATION AND CANNOT BE CONSIDERED GAIN IN REAL TERMS.

14. INTERNATIONAL RESERVE POSITION DROPPED FROM A HIGH OF \$6.8 BILLION LAST DEC TO 6.2 BILLION BY MAY. THE PROJECTIONS FOR THE YEAR ARE THAT IMPORTS WILL REACH \$15 BILLION AND EXPORTS \$7 BILLION, AND THAT THE BALANCE OF PAYMENTS WILL HAVE A CURRENT ACCOUNT DEFICIT OF \$2BILLION, AS COMPARED WITH A \$550 MILLION SURPLUS IN 1973. THIS REPRESENTS DETERIORATION EQUIVALENT TO 4 PERCENT OF THE GNP.

15. QUESTION OF HOW TO CONFRONT THIS SITUATION HAS SO FAR BEEN ANSWERED IN A RESPONSIBLE MANNER BY GOVERNMENT LEADERSHIP. THEY HAVE MADE CLEAR THEIR INTENTION TO ABIDE BY THE RULES OF INTERNATIONAL "FAIRPLAY" AND, RATHER THAN MOVE IN THE DIRECTION OF IMPORT RESTRICTIONS, HAVE BEEN FOLLOWING PROGRAM OF IMPORT LIBERALIZATION WHICH THEY SAY WILL CONTINUE. LIKEWISE, THERE HAVE BEEN OFFICIAL STATEMENTS SAYING SPAIN WOULD AVOID THE "BEGGAR-THY-NEIGHBOR" TACTIC OF COMPETITIVE DEVALUATION.

16 RATHER, WHAT IS CITED AS AN OFFICIAL COURSE OF ACTION IS TO LAUNCH A TRADITIONAL EXPORT PROMOTION PROGRAM, WHICH SEEMS TO HAVE LIMITED POSSIBILITIES FOR POSITIVE RESULTS GIVEN MAGNITUDE OF DEFICIT. ALSO CITED IS DESIRE TO BECOME LESS DEPENDENT ON PETROLEUM IMPORTS AS AN ENERGY SOURCE, RELATIVELY LONG RANGE GOAL, IMPACT OF WHICH WILL NOT BE FELT MUCH IN THIS DECADE. SIMILARLY, POSSIBLE ALTERING OF SYSTEM BY WHICH GOLD RESERVES ARE VALUED OFFERS ONLY RELATIVELY SLIGHT ADVANTAGES SINCE SPAIN'S CONFIDENTIAL

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GOLD RESERVES VALUED AT "OFFICIAL \$42 PER OUNCE PRICE ONLY AMOUNT TO SOME \$600 MILLION. WHILE THERE IS DESIRE TO RECYCLE ARAB PETROLEUM DOLLARS BACK TO SPAIN IN FORM OF LONG TERM INVESTMENTS IT MUST BE ADMITTED THAT THERE ARE OTHER ALTERNATIVES MORE ATTRACTIVE TO ARABS AND IT IS LIKELY TO REMAIN THIS WAY. ONE VARIATION ON THIS WOULD BE FOR A TRIANGULAR RECYCLING WITH US PRIVATE INDUSTRY PLAYING ROLE. TO THE EXTENT IT TAKES PLACE, IT PROBABLY SHOULD BE ENCOURAGED.

17 UNLESS THERE IS SOME RADICAL CHANGE IN THE STRUCTURE OF THE EXTERNAL SECTOR OF SPAIN'S ECONOMY, AN UNLIKELY DEVELOPMENT, THE

COUNTRY COULD BE ENTERING SERIOUS PAYMENTS PROBLEMS BY 1976-77. HOW LONG THE AVOIDANCE OF TRADE RESTRICTIONS OR MONETARY ADJUSTMENT CAN BE MAINTAINED IN THE FACE OF THIS SITUATION REMAINS TO BE SEEN.

18 PENDING COUNTERVAILING DUTY CASE AIMED AT SPANISH EXPORTS OF SHOES AND OLIVES TO THE US COULD HAVE PSYCHOLOGICAL IF NOT REA

IMPACT ON BILATERAL TRADE RELATIONS. THESE TWO PRODUCTS ACCOUNT FOR 40 PERCENT OF SPAIN'S EXPORTS TO US. TRADE DEFICIT WITH THE US IS GROWING AT AN EXTREMELY RAPID RATE AND WILL PROBABLY REACH \$1.6 BILLION FOR THE YEAR 1974, TWICE THE LEVEL* 1973. IMPORTS FROM THE US WILL INCREASE FROM \$1.5 BILLION IN 1973 TO \$2.4 BILLION IN 1974. ON OTHER HAND, WHILE SPANISH EXPORTS ARE CURRENTLY RISING AT AN OVERALL 35.6 PERCENT RATE, EXPORTS TO THE U.S. ARE INCREASING AT THE MUCH SLOWER RATE OF 6.5 PERCENT.
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